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The Roles of Acceleration

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ABSTRACT

Acceleration clauses are found in most debt instruments. Upon the occurrence of a predetermined triggering event, acceleration makes a creditor's future claim due and payable. While debt covenants have been analyzed extensively in the academic literature, the role of acceleration has been overlooked.

This Paper examines the role of acceleration clauses and maintains that they play a critical role in debt financing. This Paper argues that the prime role of acceleration is to perfect a complex set of governance mechanisms within the corporate setting. This governance role is comprised of three parts. First, acceleration is a complementary measure that supports debt covenants in mitigating ex ante the borrower's agency costs of self-interest actions. The other two parts of the governance mechanism function ex post, upon the debtor's financial distress. Each deals with disciplining a different entity that may generate wasteful costs to the creditor.

One entity that requires restraining is the debtor. Acceleration facilitates the commencement of the debtor's bankruptcy and thus curtails any prospective losses to the creditors resulting from the borrower's continuous moral hazard. The other entity a creditor must worry about, which has been widely neglected by the financial literature, is other self-interested creditors who rush to dismantle the common debtor upon the latter's financial distress. Cross-acceleration clauses place all creditors on equal footing, establish an intercreditor balance of terror and prevent the creditors from liquidating the firm prematurely. Instead, cross-acceleration leads the creditors to engage in collective negotiations and work out a comprehensive restructuring of the firm's finance.

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I. INTRODUCTION

Loan transactions strike a deal between the parties under which the borrower obtains cash from the lender in the present and promises to pay it back in the future. In exchange for its willingness to depart from cash it currently possesses, the lender is promised a fee in the form of interest payments on the principal. A loan is a transaction on the value of time, the two fundamental parameters of which are the amount to be paid[1] and the time of payment. Nonetheless, debt instruments, whether in private loans or publicly issued debt, are lengthy and contain many covenants and clauses that complement the aforementioned core terms of the loan.[2]

Acceleration clauses are invariably included in loan documents.[3] Acceleration is a dependent clause the operation of which requires triggering events. Such events are specified alongside the acceleration clause in the agreement. Any failure of the borrower to comply with one or more of the triggering clauses entitles the lender, the bondholders or their trustee to assert their right to accelerate the payment of the loan.

Acceleration is the single most anti-loan clause in a loan agreement. It collapses the entire principal and any accrued interest thereon and makes them payable at once. That is, the schedule of the loan is abandoned in favor of an immediate resolution and termination of the parties' legal relationship. Acceleration clauses are widely considered an important protection of creditors' rights. While the legal and financial literature has discussed at length the essential role of debt covenants,[4] it has barely analyzed the role and contribution of acceleration. This

1. The payment is comprised of the principal and the computed interest.

2. For further discussion *see* Part II *infra*.

3. Specifically with respect to secured loans, Grant Gilmore wrote over forty years ago that "[f]or a hundred years . . . no security agreement has failed to include an acceleration clause". 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 43.4, at 1195 (1965).

4. The seminal paper is Clifford W. Smith, Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117 (1979). This paper and the subsequent literature focused on the debt-equity agency costs. As shall be elaborated below, this paper understands some of the covenants and the acceleration clauses as tackling also an inter-creditor conflict of interest.

Paper aims to fill this gap and analyze the various roles of acceleration clauses.

A priori, acceleration may be conceived as an enforcement clause, facilitating the collection of the loan. By modifying the original terms of the agreement and making the entire amount payable on demand, the creditor may move forward and use collection measures sanctioned by the applicable debtor-creditor law.[5] In this sense, acceleration is an accessory of the contractual remedy of enforcement. However, as shall be shown in this Paper, while some triggering events justify utilizing collection measures, other events do not. Also, many creditors, such as unsecured creditors, often face an economic reality where their collection chances are dim. Thus, justifying acceleration merely as a means of collection is rather weak.

This Paper argues that beyond facilitating collection, acceleration's prime role is to enhance a creditor's control and governance. Acceleration complements the contractual covenants and serves as the ultimate stick over the heads of the disciplined constituencies. This Paper shows that acceleration can advance creditor control and discipline entities that generate wasteful costs to the creditor.

The first are the managers and equity holders of the borrower. The contractual covenants, coupled with acceleration, deter opportunistic behavior by the management at the expense of the creditors' rights. A second entity a creditor must worry about, which has been widely neglected by the financial literature, are other self-interested creditors who rush to dismantle the common debtor upon the latter's financial distress. Creditors whose claims are payable in the future lack the fundamental legal tools to practically protect their interests against a run on the debtor's assets. This Paper will argue that cross-default and acceleration clauses provide a creditor with those tools as they place all creditors on equal footing and level the play-field. By making the claims of all creditors due and payable upon the default to one creditor, acceleration clauses give each creditor a reliable threat against the other creditors – the threat of dragging the debtor into bankruptcy and thwarting their collection efforts. The all-creditor acceleration creates a constructive balance of terror among the creditors that facilitates consensual workouts.[6]

This Paper continues as follows. Part II outlines the prototypical covenants included in debt instruments and the accompanying acceleration clauses and will distinguish between payout covenants, capital

5. Prior to a debtor's bankruptcy, state law governs the debtor-creditor relationship. However, once bankruptcy has been filed the federal bankruptcy law rules.

6. *See infra* in detail Part IV.C.

structure covenants, asset substitution covenants and event risk covenants. It shall also point to the practice of including cross-default and cross-acceleration clauses in the applicable instruments.

Part III critically examines the role of acceleration clauses as a means of collection. The discussion shows that unsecured creditors, and even secured creditors to an extent, gain little if any collection benefits from acceleration. Thus, it concludes that collection is, at best, only one face of acceleration.

Part IV reveals the principal roles of acceleration. It argues that acceleration is intended to facilitate the control of a creditor over the business and the fate of the borrower before and during the latter's financial distress. *Ex ante*, debt covenants are intended to mitigate the agency costs between the equity and debt holders of the firm, with the management supposedly aligning their interests with the equity holders.[7] Acceleration solidifies the legal hold a creditor has against any borrower misbehavior. *Ex post*, once the firm has reached financial distress, acceleration can facilitate a resort to formal bankruptcy either by the heavily indebted firm or by a creditor. The threat of bankruptcy keeps the creditor's check over the management. At the same time, it also allows a creditor to credibly threaten its counterparts that if they act selfishly and refuse to negotiate collectively it shall drag the debtor along with all its creditors into court-controlled formal bankruptcy. These reliable threats serve as an impetus for consensual solutions among all interested parties.

II. DEBT COVENANTS AND ACCELERATION CLAUSES

Private loans and public debt instruments usually include covenants limiting the borrowing firm's freedom of action. Debt instruments include both affirmative and negative covenants. Affirmative covenants require the firm to discharge its fundamental contractual obligations and report to the creditor on a regular stipulated basis. Negative covenants restrict the firm's freedom to enter transactions, transfer property or initiate any other action that may increase the risk of default on the debt.[8] The firm also undertakes to maintain certain financial ratios that reduce its risk of default on the payment obligations.

7. On the management's inclination to align their interests with the equityholders even at time of the firm's financial distress, *see* Geroge G. Triantis, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. REV. 901, 918 (1993); David A. Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461, 509 (1992).

8. Edward A. Bernstein, *Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer's View of the Law & Economics Literature*, 74 OR. L. REV. 189, 222 (1995).

This part outlines the common debt covenants and the common practice of cross-default and acceleration clauses.

A. *Four Types of Covenants*

The precise nature of the covenants included in a debt instrument varies from one transaction to another. The lender's credit officers or the indenture trustee on behalf of bondholders will factor the size of the loan, the firm's financial strength, the firm's bargaining power, and the lender's degree of comfort with the firm's management into the design of the debt instrument.[9] In addition, the design will also be affected by the general conditions of the market at the time of the loan. During high tides in the financial markets creditors may display some leniency towards the borrowing firm and relax the covenants somewhat.[10] In contrast, during down periods creditors will stiffen the terms and insist on the inclusion of stricter covenants. Moreover, some covenants may be included as a periodica reaction to certain borrowers' activities and practice that have previously contributed to defaults, or merely as innovative legal and contractual fashions.[11] Nonetheless, certain prototypical covenants are common in loan transactions. These covenants may be divided into four broad groups: payout covenants, capital structure covenants, asset substitution covenants and event risk covenants.

1. Payout Covenants

This group is comprised of covenants limiting the borrower's ability to initiate distributions to its shareholders, either by formally announced dividends, spin-offs,[12] stock repurchases, stock redemptions or otherwise. Payout covenants may limit distributions by the issuer

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9. Robert M. Lloyd, *Financial Covenants in Commercial Loan Documentation: Uses and Limitations*, 58 TENN. L. REV. 335, 340 (1991).

10. The phenomenon of covenant-light loans has been common practice even in the most sophisticated and developed financial markets. This leniency was, *inter alia*, a result of the desire of hedge funds and private equity managers to close as many deals as possible and get paid their bonuses as a result thereof. *See* Harvey R. Miller, *Chapter 11 in Transition - From Boom to Bust and into the Future*, 81 AM. BANKR. L.J. 375, 380-83 (2007).

11. Yaxuan Qi & John Wald, *State Law and Debt Covenants* 51 J. L. & ECON. 179, 191 (2008).

12. Covenants combating spin-offs detrimental to the corporate bondholders are discussed in F. John Stark, III, J. Andrew Rahl, Jr. & Lori C. Seegers, *"Marriott Risk": A New Model Covenant to Restrict Transfers of Wealth from Bondholders to Stockholders*, 1994 COLUM. BUS. L. REV. 503.

alone or may limit business group payouts, namely by subsidiaries and affiliates of the issuer.[13]

2. Capital Structure Covenants

Capital structure covenants restrict the debtor's freedom to finance its business through relatively risky capital structures. This group includes covenants that limit the total debt a debtor may incur, either in a total amount or through assets to liabilities or current assets to current liabilities ratio, and covenants that limit the aggregation of debt through controlled subsidiaries. In addition, negative pledge clauses[14] are covenants that often curtail the debtor's practical ability to finance itself with additional debt.[15] Negative pledge clauses protect the holders of unsecured debt,[16] while secured debt is complemented by covenants restricting junior liens.[17] By imposing the aforementioned limitations these covenants effectively design the firm's capital structure.

3. Asset Substitution Covenants

These covenants limit the firm from engaging in various transactions that may result in substitution of high risk and volatile assets for solid and low risk assets. Such transactions may include asset sales and investments by the borrower firm alone, or through its subsidiaries.[18]

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13. Payout covenants also effectively design the borrower's capital structure, alongside the direct capital structure covenants, because these covenants make the payouts a function of the borrower's capital structure. John K. Wald, *Capital Structure with Dividend Restrictions*, 5 J. CORP. FIN. 193 (1999). Qi and Wald found recently that corporate state laws with stricter distribution rules serve as a proxy for payout covenants. Qi & Wald, *supra* note 11, at 191-94.

14. For a discussion whether a negative pledge clause constitutes an Article 9 security interest *see generally* Thomas C. Mitchell, *The Negative Pledge Clause and The Classification of Financing Devices - A Question of Perspective*, 60 AM. BANKR. L.J. 153 (1986). *See also* Peter F. Coogan, Homer Kripke & Fredric Weiss, *The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements*, 79 HARV. L. REV. 229 (1965). For an understanding of negative pledge clauses as mere contractual (and thus, unsecured) undertakings of debtors, *see e.g.* Randal C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645, 652 (1992).

15. McDaniel noted that negative pledge clauses are often complemented by covenants barring the borrower from entering into sale and leaseback transactions, since such transactions may serve as a proxy to security interests. Morey W. McDaniel, *Are Negative Pledge Clauses in Public Debt Issues Obsolete?*, 38 BUS. LAW. 867 (1983).

16. Carl S. Bjerre, *Secured Transactions Inside Out: Negative Pledge Covenants, Property and Perfection*, 84 CORNELL L. REV. 305, 311 (1999).

17. Lloyd, *supra* note 9, at 340-41.

18. Qi and Wald consider also sale and leaseback covenants as asset substitution covenants. Qi & Wald, *supra* note 11, at 188, Table 1. However, these transactions are financing transactions in which the nature of the firm's assets is not altered.

4. Event Risk Covenants

This group includes covenants that make substantial alterations of the firm's risk profile, initiated by the firm or a third party, in the event of a default.[19] Alterations of the firm's risk profile include the acquisition of a certain percentage of the debtor's shares by a third party, a merger or consolidation, a change in the composition of the board of directors, or a repurchase by the borrower of certain percentage of its own shares. Change of control exacerbates the risk to other creditors when it involves a leveraged acquisition.[20] Event risk covenants may be accompanied by a clause that entitles the creditors to contractual remedies only when they trigger a credit rating decline.[21]

B. *Cross Defaults*

Aside from specified covenants, debt contracts invariably contain cross-default clauses. These clauses trigger defaults by the borrower vis-à-vis its other creditors once a payment or another default occurred in its contractual relationship with any one of its creditors. Also, under such clauses the initiation of enforcement actions by an informed third party, such as levying of the borrower's assets, the imposition of a judgment lien or even the filing of a lawsuit against the borrower triggers a default on the debt contract.[22]

C. *Acceleration Clauses*

Complementing the various covenants in debt contracts are acceleration clauses. Acceleration clauses entitle the lender or the indenture trustee, on behalf of the bondholders, to accelerate the entire principle upon the occurrence of specified events and make it immediately due and payable regardless of the original payment terms of the contract.

The triggering events for acceleration vary. First and foremost, a loan will be accelerated upon the borrower's default on its payment obligation. In addition, the borrower's failure to comply with its capital structure covenants or its violation of the payout or event risk cov-

19. Paul Asquith & Thierry A. Wizman, *Event Risk, Covenants, and Bondholder Returns in Leveraged Buyouts*, 27 J. FIN. ECON. 195 (1990).

20. Kahan and Klausner identify event risk covenants primarily with a change in the borrower's credit quality. *See* Marcel Kahan & Michael Klausner, *Antitakeover Provisions in Bonds: Bondholder Protection or Management Entrenchment?*, 40 UCLA L. REV. 931 (1993).

21. Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 741-42 (1997).

22. *See* Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign versus Corporate Debt*, 75 U. CIN. L. REV. 977, 980 (2007).

enants will awake the lenders' or bondholders' right of acceleration. Furthermore, acceleration clauses may provide that the lender or bondholders' may accelerate the loan whenever they feel that the prospect of payment is impaired due to negative news or adverse information about the borrower's business.[23]

In accord with the practice of cross-default provisions debt contracts also contain cross-acceleration clauses.[24] Cross-acceleration entitles the lender to accelerate and call its loan upon acceleration by any other creditor on its loan.[25]

To the extent the materially adverse changes reflect an insolvency-related event the loan will be accelerated automatically and immediately; while other events, such as failure to comply with affirmative covenants, may trigger a deferred right to accelerate that will materialize only after the expiration of a grace period for curing the failure and complying with the terms of the contract.[26]

III. THE COLLECTION ROLE OF ACCELERATION

Studying the essential role of acceleration begins with its power to promote collection. This part examines the contribution of acceleration to the collection of debts. Analyzing acceleration clauses in secured debt instruments first and then in unsecured debt instruments, this Paper shows that when the borrowing firm is in a dire financial state the collection of many claims is hardly practical.

A. *Means of Collection*

The most trivial and readily apparent role of acceleration is to facilitate the creditor's right to collect its loan. It allows the lender to abort the contractual time schedule for payments and extract from the firm all payments at once. This immunizes the creditor from any future adverse events. To the extent the triggering event is a periodical pay-

23. R. Wilson Freyermuth, *Enforcement of Acceleration Provisions and the Rhetoric of Good Faith*, 1998 BAYLOR LAW. REV. 1035; Bernstein, *supra* note 8.

24. Qi & Wald, *supra* note 11, at 187-88. Interestingly, they found cross-acceleration clauses in 52.7% of the bonds in their sample while cross-default clauses were found in only 4.2%. *Id.* at Table 1. This may indicate that acceleration, and cross-acceleration as a result thereof, are triggered more by general material adverse changes in the firm's state than by violations of specific covenants.

25. For a study of cross-acceleration clauses in public debt instruments and their relation to the debtholders' decision to delegate the borrower's monitoring to the banks *see* Anne Beatty, Scott Liao & Joseph Weber, *Evidence on the Determinants and Economic Consequences of Delegated Monitoring* (U. Toronto, Dec. 2008), *available at* http://www.rotman.utoronto.ca/accounting/S.Liao.pdf (last visited Jan. 18th, 2010).

26. George A. Nation, III, *Prepayment Fees in Commercial Promissory Notes: Applicability to Payments Made Because of Acceleration*, 72 TENN. L. REV. 613, 624 (2005).

ment default, acceleration effectively terminates the parties' ongoing contractual relationship.

When the triggering default is not a payment obligation but rather the failure to comply with another contractual covenant, acceleration epitomizes an anticipated contractual breach of the payment obligations.[27] It entitles the prospective aggrieved party, the lender, to spare itself the adverse effects of a future actual payment default and enhances its collection of the loan. By collecting its loan upon the occurrence of a single default, the lender mitigates any foreseeable damages it may sustain should it await and pursue collection only on the original payment dates.[28]

Viewed from this ex post perspective, acceleration is primarily an accessory to the payment obligations of the borrower. Acceleration clauses are the contractual bridge between actual or anticipated violations of payment obligations and the contractual remedies of full performance or damages.

B. *The Limited Efficacy of Collection*

Acceleration clauses are found both in unsecured and secured debt contracts. To the extent acceleration facilitates the collection of the debt, it appears applicable regardless of the debt's priority ranking. Yet the following discussion shows that collecting an accelerated unsecured debt is vastly different than collecting an accelerated secured debt. The dim chance of collection faced by unsecured creditors when a debtor experiences financial distress demonstrates the limited efficacy of acceleration as a mere collection measure and highlights the need for a richer understanding of acceleration. The next part will develop such an understanding by exploring and analyzing the role of acceleration clauses as mechanisms of governance.

1. Secured Debt

When collateral secures a private loan or publicly issued bonds, acceleration assists the claimants to collect from the borrowing firm.

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27. *See also* Darlene M. Nowak, *Standards for Insecurity Acceleration Under Section 1-208 of the Uniform Commercial Code: A Proposal for Reform*, 13 U. MICH. J.L. REFORM 623, 624 (1979-1980) (a creditor's stipulated right of acceleration when it deems its interests insecure is recognized both under the U.C.C. and under the common law).

28. This protection of the lender is particularly important in contractual relationships under which the creditor provides an ongoing revolving credit to the borrowing firm. By accelerating the outstanding debt and terminating the contract the creditor absolves itself from risking future credit to the firm. A similar approach can be found in bankruptcy. Section 365(b) of the Bankruptcy Code relieves the non-debtor party from continuing subjecting itself to an executory contract absent the curing of all past defaults by the debtor.

Under the law of secured transactions, a creditor cannot foreclose on the collateral before the specified time of payment or the occurrence of another default.[29] To the extent the payment of the loan is in the far future, the creditor is vulnerable to adverse changes in the firm's conditions that may impair chances of collecting the full claim upon the predetermined payment date. Acceleration clauses may be understood as the mechanism abridging the time gap between the future due date of the payment and the current precarious financial state of the debtor. By entitling the creditor to accelerate once the firm has financially deteriorated, acceleration clauses enhance the creditor's foreclosure rights and dramatically improve its ability to collect.[30] Absent acceleration, the creditor would be compelled to watch the debtor's deterioration without any legal means to protect its claim before its own payment's due date.

Foreclosure and collection are justified where future payments to the creditor are at risk. Yet, a close look at the various debt covenants reveals that the link between certain covenants and an actual risk to the secured creditor's collection rights is relatively remote. To the extent that a covenant violation impairs or threatens to impair the value of the creditor's collateral, seizing the collateral at its present state and initiating foreclosure fixes the creditor's position and spares it any loss due to future devaluation. Thus, an asset substitution violation or distributions to the shareholders out of a creditor's collateral justify acceleration and collection of the debt as a measure of stopping the creditor's own bleeding. In contrast, the violation of risk event covenants, such as a change of control of the borrower or an alteration of the composition of the borrower's board of directors, does not necessarily entail a direct and actual risk to the value of the collateral even if the change of control entails an increase in the firm's leverage. In a similar vein, the borrower incurring debt beyond the maximum contractual dollar amount allowed does not impede the secured creditor's senior payment rights from its collateral.[31] A creditor is concerned primarily with the size of the slice it shall actually receive from the debtor's pie once its payment is due. Securing its claim with collateral and gaining priority as a result thereof is a sufficient protection of the

29. *See generally* U.C.C. § 9-501(1).

30. Similarly, by making a monetary claim due and payable acceleration facilitates common law set-off between two bank accounts owned by an identical customer. *See* Edward L. Rubin, *The Code, the Consumer, and the Institutional Structure of the Common Law*, 75 WASH. U. L. Q. 11, 39 (1997).

31. Limitations on the borrower's power to incur debt are categorized as capital structure covenants. *See supra* Part II.A.2.

creditor's interests.[32] Through its collateral the secured creditor enjoys absolute priority over any other claimant once the creditor's payment becomes due, or – in the case of bankruptcy – when all payments become due.[33] Even acceleration by another junior creditor will not impair the creditor's right to get the first bite at the collateral. It follows that acceleration based on defaults not related to the value of the collateral cannot be explained merely as a measure facilitating collection by the secured party.

2. Unsecured Debt

In theory, unsecured creditors would like to maintain an exit, or call, option on their loan upon the occurrence of certain adverse events in the firm's backyard. To avoid suffering from the continuing deterioration of the firm and the value decrease of their expected collection upon the original due date, unsecured creditors include acceleration clauses in the hope of cutting their losses.

Yet, this explanation of acceleration is again unpersuasive. This understanding of acceleration essentially justifies a creditor's strategy of "take the money and run." From an individual creditor's vantage point this may indeed be the desired strategy, but from the perspective of social welfare this strategy is liable to prove destructive as it reduces the overall return to the creditors as a group. Condoning acceleration as a device for early collection jump starts the famous prisoner's dilemma of "race to collection,"[34] which underscores the need for a collective regime, like bankruptcy, to resolve the creditors' rights.[35] Unsecured claims have no priority and rank equal to one another (*pari passu*). A collection by one creditor is no more justifiable than the collection by any other unsecured creditor. To the extent

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32. *But see* Thomas S.Y. Ho & Ronald F. Singer, *Bond Indenture Provisions and the Risk of Corporate Debt*, 10 J. FIN. ECON. 375 (1982) (arguing that the full payment of short-term junior debt may impair the rights of long-term senior debt holders).

33. The commencement of a bankruptcy case constitutes an acceleration of all claims against the debtor. *See, e.g.* Theodore Eisenberg, *A Bankruptcy Machine That Would Go of Itself*, 39 STAN. L. REV. 1519, 1529-30 (1987).

34. Stanley D. Longhofer & Stephen R. Peters, *Protection for Whom? Creditor Conflict and Bankruptcy*, 6 AM. L & ECON. REV. 249 (2004); Sayantan Ghosal & Marcus Miller, *Co-ordination Failure, Moral Hazard and Sovereign Bankruptcy Procedures*, 113 ECON. J. 276, 281-84 (2003); J. Bradley Johnson, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 233 *et seq.* (1991).

35. Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and Creditors' Bargain*, 91 YALE L.J. 857, 907 (1982); THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW Ch. 1 (1986); *see also* Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993) (arguing that bankruptcy is no less a political compromise accepted by the parties than a pure solution to the economic problem of a common pool). .

the debtor's financial conditions deteriorate and all creditors fear that eventually they will not be paid in full, a multi-party race to collect transpires, which further tailspins the debtor, to the detriment of the creditors as a whole.[36] Acceleration exacerbates this race to collection as it allows more creditors to presently join the race. It facilitates collection by the speedy and skilled creditors with the potential of further harming the less fortunate ones.[37]

Moreover, in the case of a debtor who is also indebted to secured creditors acceleration by unsecured creditors upon the deterioration of the debtor's financial state seems somewhat futile. Given the common practice of including cross-acceleration clauses in debt contracts, the acceleration of unsecured debt would only expedite foreclosure by secured creditors on their collateral. This would pave a short path to liquidation of the debtor and leave the unsecured creditors, *i.e.,* the triggering creditors, with hardly any value for collection.

In the best case scenario (from an individual creditor's perspective) an astute creditor may benefit from expedited collection. But given the detrimental effect for the debtor and the creditors as a whole it is doubtful whether this collection is desirable. Moreover, to the extent that the debtor will enter bankruptcy within three months after the collection by the accelerating creditor that creditor's success will be negated as the collection would be challenged as an avoidable preference.[38]

Thus, from the perspective of unsecured creditors acceleration generates little, if any, collection benefits. Actual collection notwithstanding, a default on debt covenants, backed by an acceleration clause, may nonetheless strongly affect the operations of the borrower firm. This is discussed in the following part.

IV. THE GOVERNANCE ROLES OF ACCELERATION

Going against conventional wisdom, it is arguable that the prime roles of acceleration clauses are enhancing efficient corporate governance. Acceleration serves the creditor both *ex ante* and *ex post. Ex ante* it deters strategic, self-interested behavior on the part of borrowers during the life of the underlying debt. *Ex post,* once the borrowing firm faces financial distress, acceleration allows the creditor to curtail

36. The race to collection may also exacerbate a zero-sum game. WINTON E. WILLIAMS, GAMES CREDITORS PLAY Ch. 4 (1998).

37. Acceleration clauses are most common in debt instruments negotiated and executed by financial institutions or a skilled indenture trustee.

38. Bankruptcy Code §547(b), 11 U.S.C. § 547 (2006).

any further damage potentially inflicted by the equity-management coalition and suspend self-interested actions taken by other creditors.

This part examines three constructive roles of acceleration as a tool of governance. First, it examines acceleration as a complementary element of debt covenants in combating the debt agency costs. Secondly, it portrays acceleration as an effective means to commence timely bankruptcy cases and bar future mismanagement of the borrower firm. Finally, it discusses the contribution of acceleration as a means of inducing creditors with conflicting interests to negotiate collectively and design a comprehensive workout for the distressed firm.

A. *Governing Debtor Misbehavior*

1. The Debt Agency Problem

The complicated and intertwined effects of a firm's finance sources, namely equity and debt, on the managing of its affairs have spawned a large volume of academic literature. On one hand, debt is considered a positive component of a firm's financing. Debt financing has been understood as an effective restriction on management's control over the firm's free cash flow. That is, debt forces management to pay out its accumulated cash to the investors and frustrates any self-interested plans of managers to maintain the generated cash in the firm for advancing their personal benefits (increased compensation, promotion etc.).[39] In addition, by imposing the possible costs of bankruptcy, debt is desirable for equity holders as it threatens the management and compels it to manage the firm with care.[40] Also, as debt substitutes equity in the firm's capital structure a fixed equity investment by the managers represents an increasing proportion of total equity. This reduces the agency costs between management and the equity holders and encourages the managers to maximize the return on equity.[41]

On the other hand, the very existence of debt alongside equity exacerbates the agency problem between these two interested groups of investors. This agency problem was first analyzed over thirty years

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39. Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, 76 AM. ECON. REV. 323, 324 (1986).

40. Sanford J. Grossman & Oliver Hart, *Corporate Financial Structure and Managerial Incentives*, *in* THE ECONOMICS OF INFORMATION AND UNCERTAINTY 107 (1982); *see also* Allen N. Berger & Emilia Bonaccorsi di Patti, *Capital Structure and Firm Performance: A New Approach to Testing Agency Theory and an Application to the Banking Industry*, 30 J. BANKING & FIN. 1065, 1071-72 (2006).

41. Adler, *supra* note 35, at 317.

ago by Michael Jensen, William Meckling and Eugene Fama.[42] The debt agency problem drives the firm's managers to take deliberate actions that increase their pecuniary compensation and the expected return on equity while imperiling the firm's overall value and thus potentially impeding the return to its debt holders. Barring any restrictions, upon the obtaining of debt managers are liable to gamble on the creditors' money in various ways including: extending generous payouts to themselves and the equity holders, over or under investing, increasing the firm's leverage, or engaging in asset substitution.[43] This externalization is aggravated when the firm incurs more debt and increases its risk of insolvency.[44]

2. Covenants as Tools of Governance

Unlike shareholders, creditors hardly enjoy corporate statutory or case law rights. The financial agency problem is addressed primarily by contractual measures. Since the seminal paper by Smith and Warner, it has been widely acknowledged that debt contracts and the covenants included therein serve as an important mechanism combating the agency costs of debt.[45] The contractual covenants are a bonding device that decreases the cost of credit.[46] Through the covenants the firm (or its managers) undertakes to abstain from the aforementioned corporate activities that may impede the creditors' investments. These contractual undertakings will be monitored, and if necessary, enforced by the private lender, the bondholders, or a delegated monitoring agent on their behalf.[47] The creditors may enforce their interests and gain effective, albeit informal, control and influence over the corporate affairs.[48] The debt contract is an important mechanism for imposing a check on management's wide discretion in operating and

42. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305 (1976); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. Pol. Econ. 288 (1980).

43. Smith & Warner, *supra* note 4.

44. Richard C. Green & Eli Talmor, *Asset Substitution and the Agency Costs of Debt Financing*, 10 J. Banking & Fin. 391 (1986).

45. Smith & Warner, *supra* note 4.

46. A substitute measure for controlling the debt-equity conflict is the extension of short-term credit. This limits the managers' opportunities to expropriate the corporate assets in favor of the equity holders. Matthew T. Billett, Tao-Hsien Dolly King & David C. Mauer, *Growth Opportunities and the Choice of Leverage, Debt Maturity, and Covenants*, 62 J. Fin. 697, 697 (2007).

47. Mitchell Berlin & Jan Loeys, *Bond Covenants and Delegated Monitoring*, 43 J. Fin. 397, 398 (1988); *see generally* Douglas W. Diamond, *Financial Intermediation and Delegated Monitoring*, 51 Rev. Econ. Stud. 393 (1984).

48. Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. Rev. 115, 127-28 (2009).

financing the firm.[49] It is a central piece of the creditors' tools of corporate governance, alongside the obtaining of security interests[50] or the breaking of the firm's assets and operations into separate corporate entities.[51]

Some commentators view the operation of covenants as a governance measure intended to hold management at bay with the benefits of this control inuring to all stakeholders, debt and equity alike.[52] That is, they view the operation of debt covenants as a tool in the arsenal against management's agency problem *vis-à-vis* all the firm's investors rather than the narrow scope of the equity-debt agency problem.[53]

A close examination of the prototypical covenants reveals that they are designed particularly to serve as an *ex ante* deterrence against the hazard of borrower misbehavior. The payout covenants restrain the firm's management and directors from displaying over-generosity to the shareholders at the expense of a diluted pool of assets left for repaying the firm's creditors.

Event risk covenants work similarly. Requiring the consent of a creditor to a change of control of the borrowing firm is intended to limit the creditor's exposure to increasingly risky investments and operations. The creditor has not negotiated the extension of credit with the new group acquiring the control. The new controlling group's business philosophy may pose an excessive level of risk to the creditor. Hence, the creditor includes a covenant requiring its consent to the change of control to combat such a conspicuous alteration in the borrowing firm's risk profile

The financial structure covenants provide a buffer against the management's inclination to over-borrow and expand the firm's acquisi-

49. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1216 (2006).

50. On security interests as a monitoring device on the firm's management *see, e.g.*, Saul Levmore, *Monitoring and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 55-57 (1982); Ronald J. Mann, *The Role of Secured Credit in Small-Business Lending*, 86 GEO. L.J. 1, 11-25 (1997); *see generally* Alan Schwartz, *A Theory of Loan Priorities*, 18 J. LEGAL STUD. 209 (1989); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901 (1986).

51. On the virtue of separation of corporate entities *see* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 393 (2000).

52. Douglas G. Baird & Robert K. Rasmussen, *The Prime Directive*, 75 U. CIN. L. REV. 921, 937 (2007); George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CALIF. L. REV. 1073, 1093 (1995).

53. Joanna M. Shepherd, Frederick Tung & Albert H. Yoon, *What Else Matters for Corporate Governance?: The Case of Bank Monitoring*, 88 B.U. L. REV. 991, 1010 (2008).

tions and business development beyond its projected cash-flow.[54] Through the contractual requirement to preserve a certain positive net worth the equity holders are left with a significant stake in the firm that they might lose should the management mismanage the firm. Thus, it secures the effective monitoring of the management's actions by the equity holders from which the debt holders benefit.

3. Acceleration – Perfecting the Governance

Debt covenants are intended to deter borrower misbehavior, ameliorate the risk of payment defaults, and preserve the value of the creditors' investment. The covenants are thus the cause for a creditor's action. Acceleration is the means of action. Through its right to accelerate the debt, the creditor can materialize the consequences of a covenant violation and inflict severe harm to the borrower's operations and survival as a viable entity. It is the ultimate threat of a creditor against the borrower or its management. It translates a non-payment default into an actual payment default and negates the firm's benefit of utilizing the creditor's investment over time. Absent the creditor's contractual power to call the entire loan back the force of the covenants would diminish. A borrower who is aware of the limited enforcement options of its creditors would attach a lower price tag to a potential covenant violation. Acceleration is, thus, the complementary measure that adds credibility to the covenants' intended deterrence. It perfects the threat by signaling to the borrower that it better not dare to even think about violating the covenants.[55]

Some commentators emphasized that the efficacy of debt covenants as a means of governance is not contingent on actual acceleration and collection of the debt. Once a violation has occurred the creditor has an option to accelerate, but it may elect to not exercise it. Rather, creditors may prefer to renegotiate the terms of the loan with the violating firm and proceed with their investment.[56] The creditor's actual choice notwithstanding, acceleration's force lies in its threatening po-

54. The contractual limitation of merger transactions combats both the peril of surpassing the borrower's allowed maximum leverage ratio and the risks inherent in the change of control of the business. The increase of leverage entailed in a merger transaction may result from the financing of the acquiring corporation through debt or from the target corporation being overloaded with debt.

55. Another method to combat voluntary defaults by a borrower is to complicate the borrower's ability to restructure the loan after the occurrence of the default. This can be accomplished by involving a large number of creditors in a loan syndicate. Benjamin C. Esty & William L. Megginson, *Creditor Rights, Enforcement, and Debt Ownership Structure: Evidence from the Global Syndicated Loan Market*, 38 J. FIN. & QUANTITATIVE ANALYSIS 37, 53 (2003).

56. Michael J. Barclay & Clifford W. Smith, Jr., *The Maturity Structure of Corporate Debt*, 50 J. FIN. 609, 611 (1995).

tential.[57] *Ex post*, a creditor may actually call the loan back through acceleration (applying an exit strategy) or renegotiate the loan (applying a voice strategy), but *ex ante* the borrower's management realizes that the ultimate destructive alternative, acceleration, is a loaded gun the creditor points to its head. Thus, management's slack is contained.

B. *The Gate to Insolvency*

An additional important role of acceleration can be seen in the context of insolvency. Upon a payment default or financial deterioration, acceleration can expedite the resolution of insolvency related interests of creditors. Two matters may be resolved by acceleration. First, acceleration of the entire loan may render the borrower insolvent and thus end its free control over its assets. Secondly, acceleration may facilitate the procedural standing of a creditor to file an involuntary bankruptcy petition against the borrower. These matters are discussed below.

1. Accelerating Insolvency

By making the entire loan due and payable upon a payment default acceleration substantiates the borrower's state of insolvency or near insolvency. It makes the curing of the default practically impossible.[58] This helps address a transpiring debt-equity conflict of interest. Acceleration refutes any potential attempt by equity holders, upon the payment default, to infuse minimal cash contributions and extend their hold and control over the financially distressed borrower.[59] That is, beyond its role as an *ex ante* deterrent against borrower's misbehavior, upon actual contract violation acceleration effectively bars any future harm and subsequent payment or non-payment violations by the equity-management coalition. This coalition has everything to gain from future activity but little to lose. Acceleration blocks their continuous gambling with the creditors' money[60] and practically forces the management to file for bankruptcy protection of the firm.

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57. Gulati & Triantis, *supra* note 22, at 980-81.

58. Paul B. Lewis, *Can't Pay Your Debts, Mate? A Comparison of the Australian and American Personal Bankruptcy Systems*, 18 BANK. DEV. J. 297, 314 (2002).

59. Adler, *supra* note 41, at 325.

60. In this sense, acceleration is a practical proxy to a party's right to terminate a contract upon its breach by the counter-party. Termination is of little use in situations when the non-breaching party has completed performing all of its obligations under the contract. Thus, the creditor who has already advanced the loan is better off accelerating the repayment of the loan and collecting from the borrower than merely terminating the contract and suing the borrower in court for restitution damages.

2. Facilitating Involuntary Petitions

Another feature of acceleration is that it translates future payment obligations to due and current payments. A creditor may wish to assert its rights against the ailing firm once its financial state deteriorated. Yet, to the extent that creditor's entire claim is payable only in the future it may presently lack the necessary standing to act against the firm. Accelerating the payments allows the creditor to take timely action and protect the value of the firm's assets from future decrease.

A creditor may protect the firm's assets from misuse by filing an involuntary bankruptcy petition. Assuming the firm will controvert the involuntary petition, the court will order relief against the debtor firm only if it "is generally not paying its debts as they become due".[61] Absent acceleration, the creditor may fail to establish that the firm is generally not paying its debts as they become due. The test courts have applied for determining whether a debtor is generally not paying its debts as they become due is a weighted average test which factors various elements such as the number of debts, the amount of the delinquency, the materiality of the nonpayment, the nature and conduct of the debtor's business, the amount of the debtor's debts compared to the debtor's yearly income and the debtor's voluntary shutdown of operations.[62] Given this test, acceleration solidifies the creditor's petition as it increases the amount of current debt that is due and cannot be paid by the debtor firm.

This role of acceleration is specifically important in jurisdictions that are less hospitable to corporate reorganizations and rely more on insolvency proceedings such as liquidation or receivership commenced by creditors to resolve a debtor's financial distress. In contrast, the vast majority of bankruptcy cases in the U.S. are commenced voluntarily by the debtor.[63] Nonetheless, as discussed above, even in such a regime acceleration is likely to drive the borrower's management to file for bankruptcy.

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61. Bankruptcy Code § 303(h)(1), 11 U.S.C. § 303(h)(1) (2006).

62. 2-303 COLLIER ON BANKRUPTCY P 303.14(b)(1) (15th ed. 2008).

63. *See, e.g.*, Robert M. Lawless & Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743, 749, n.11 (2005); Ethan S. Bernstein, *All's Fair in Love, War & Bankruptcy? Corporate Governance Implications of CEO Turnover in Financial Distress*, 11 STAN. J. L. BUS. & FIN. 298, 299, n.3 (2006); Kenneth Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, Table 3 (Jan. 8, 2008). COLUMBIA UNIVERSITY CENTER FOR LAW AND ECONOMICS STUDIES, RESEARCH PAPER SERIES NO. 321 *available at* http://ssrn.com/abstract=1081661

C. *Encouraging Inter-Creditor Arrangements*

Governing the debtor's misbehavior and facilitating insolvency are two related roles of acceleration. Both explain acceleration as a means of protecting the rights of the accelerating creditor or the creditors as a whole *vis-à-vis* the debtor, its management and its equity holders. Yet these roles of acceleration still fail to explain certain aspects of its operation. First, the inclusion of acceleration in unsecured or junior debt contracts is hard to justify based on these roles. Secondly, these roles cannot explain accelerations that are triggered by events that are beyond the management's control.

In the following paragraphs, I shall argue that in such circumstances acceleration should be viewed as an inter-creditor oriented vehicle, intended to facilitate collective creditor arrangements upon the insolvency of the common borrowing firm.

1. The Limits of Debtor Oriented Acceleration

Monitoring borrower misbehavior is predicated on effective deterrence. Creditors can deter the firm either through the threat of withholding potential future advances of credit or through the threat of calling the current loan back. Acceleration is the necessary element that makes the stick held by the creditor over the borrower's head truly intimidating and effective. I have shown above that upon the deterioration of the borrower's financial state, unsecured creditors are less likely to pursue collection since the prospect of prevailing is bleak.[64] The creditors' weak interest to collect at a time the borrower is in dire straits is no secret to the firm's management. Thus, upon the firm's financial distress, at the point where the debt agency hazard is most acute, acceleration clauses barely deter the management and the risk of misbehavior is aggravated.[65]

To be sure, debt covenants may nonetheless maintain their deterring effect even when the borrowing firm is in financial distress. To the extent a default on the covenants entitles the creditors to remove the management from office and appoint a new executive team at the corporate helm, the covenants appear to be as powerful as before.[66] Yet, this constructive disciplining effect has relatively little to do with acceleration.

64. *See supra* Part III.B.2.

65. Acceleration is likely to restrain the management at earlier stages, before the firm encounters financial distress. Thus, early acceleration may be justified under the "controlling the borrower" role of acceleration. The main text argues, however, that the more severe the firm's actual financial state the weaker this rationale of acceleration.

66. *See* Baird & Rasmussen, *supra* note 49 at 1233.

Another problem with the debtor disciplining rationales of acceleration is that certain defaults and triggering events are unrelated to any borrower misbehavior and may be beyond management's control.[67] For example, financial structure covenants may require the firm to maintain certain financial ratios throughout the life of the loan. Failure to maintain such ratios constitutes default and accelerates the payment of the entire loan. While a firm's failure to meet a stipulated financial ratio may be the result of poor managerial decisions, it may also result from general, non-firm specific, circumstances such as a general depreciation in the value of assets in the market.[68] Likewise, an economic downturn may trigger defaults on loans across the board.[69]

Acceleration may also be triggered by cross-default clauses. The filing of a lawsuit against the borrower by a third party or levying on a borrower's asset by one of its creditors may trigger a cross-default and entitle another creditor to accelerate.[70] Yet the underlying triggering event once again may be beyond the management's control.

The role of acceleration as a debtor disciplining measure fails to justify accelerations triggered by the aforementioned events. Deterrence against actions beyond the control of a disciplined person is simply irrelevant.

2. An Inter-Creditor Balance of Terror

The virtue of acceleration in the case of a borrower's financial distress lies in its constructive effect on the creditors' internal conflict regardless of the firm and its management. Once a common debtor enters a phase of financial deterioration, the creditors face a common pool problem and are tempted to act in a selfish manner to enhance one's own collection even if it sabotages the collective good of the

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67. Setting quantity covenants that are beyond the management's control is more frequent in private lending contracts than in public debt offerings, because the parties to these contracts are fewer and their ability to closely monitor such clauses and renegotiate upon the firm's failure to meet the covenant is better. Marcel Kahan, & Bruce Tuckman, *Private vs. Public Lending: Evidence from Covenants*, UCLA Anderson Graduate School of Management. (1993), *available at* http://www.escholarship.org/uc/item/1xw4w7sk.

68. Richard M. Gray, *Does the Crisis Bring Default under MAC Clauses?*, 17 INT'L FIN. L. REV. 17, 18-19 (1998).

69. Certain debt instruments may exclude changes in general economic conditions. Yet the covenants and their exclusions are subject to interpretation. Thus, invoking default based on general economic changes invites litigation. Victoria Ivashina, & David Scharfstein, *Bank Lending During the Financial Crisis of 2008*, p.14, n.10 (July 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297337.

70. Gulati & Triantis, *supra* note 22 at 980.

creditors as a whole.[71] An adverse race to collection is liable to squander the debtor's property and destruct its going-concern value.[72] Creditors with junior priorities or creditors whose payments dates are in the distant future are concerned that the senior and expedient creditors will press for an expedited and sub-value maximizing foreclosure on the borrower's property that eventually will leave them empty handed. On the other hand, senior creditors are concerned that expedient junior creditors may interfere with their collateral, forcing the senior creditors to foreclose early and thus frustrate the undisturbed stream of payments by the firm.

Cross-defaults and cross-acceleration are the weapons by which creditors discipline one another. By making the violation of a covenant to one creditor or the acceleration by that creditor an event of acceleration towards other creditors of the debtor, the other creditors assert a firm position to take necessary legal actions to protect their claims and prevent an unnecessary or hasty liquidation of the debtor's property. Even if collection of their own claims is impractical because of their junior priority or the low value of the total debtor's assets, the accelerated debts allow the other creditors nonetheless to initiate a formal bankruptcy case. The opportunity to initiate bankruptcy, either by filing their own involuntary petition or by driving the debtor's management to file a voluntary petition as a defense against the accelerated debts,[73] is an effective threat through which each creditor draws the attention of the other creditors to its rights. A bankruptcy filing is a unilateral act that a creditor may utilize should it feel deprived by other creditors. The filing of a bankruptcy petition entails the automatic stay against all creditors, unsecured and secured alike,[74] and subjects them to the jurisdiction and rulings of a bankruptcy court. Similarly, through bankruptcy creditors may avoid and recover a recent payment made to another unsecured creditor as a preference.[75]

To the extent the creditors wish to avoid bankruptcy, its formalities and limitations, the mutual threat by creditors against one another

71. Susan Block-Lieb, *Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case*, 42 AM. U. L. REV. 337, 343 (1993); Richard V. Butler and Scott M. Gilpatric, *A Re-Examination of the Purpose and Goals of Bankruptcy*, 2 AM. BANKR. INST. L. REV. 269, 269-73 (1994).

72. Picker argued, however, that according priority to secured creditors prevents the creation of a common pool in the first place and discourages other creditors from asserting wasteful collection actions. Picker, *supra* note 14 at 657.

73. *See supra* Part IV.B.2.

74. Bankruptcy Code § 362(a), 11 U.S.C. § 362 (2008).

75. *Id.* § 547. The preference provision of the Bankruptcy Code may serve as the very catalyst for a bankruptcy filing. Daniels & Triantis, *supra* note 52 at 1095.

acts as an impetus for all parties to negotiate collectively and work out a consensual liquidation or reorganization plan.[76] Acceleration thus drives the parties towards a consensual conclusion for the debtor's financial distress. That is the added value of cross defaults and cross accelerations.

V. CONCLUSION

Acceleration clauses are a fixture in debt instruments. They accompany the debt covenants and provide that upon the default on one of these covenants or upon general adverse material changes in the borrowing firm's financial state the entire claim of the creditor shall become due and payable, regardless of the original schedule of payments. This Paper explored the functions of acceleration clauses in light of the fact that upon a firm's financial distress many creditors find that collection actions are by and large useless.

This Paper argued that the primary roles of acceleration are to perfect a complex set of governance mechanisms within the corporate setting. The most apparent role is to complement the debt covenants in deterring borrower misbehavior. This Paper has shown, however, that this role of acceleration loses force when the firm has already deteriorated financially. Yet, acceleration plays two additional roles. First, it facilitates the commencement of bankruptcy and thus curtails any prospective losses to the creditors. Secondly, cross-accelerations establish a mutual balance of terror between the various creditors and prevent them from premature liquidation of the firm. Instead, cross-acceleration leads the parties to engage in collective negotiations and work out a comprehensive restructuring of the firm's finance.

76. For a negotiations oriented view of formal reorganizations under chapter 11 of the Bankruptcy Code *see* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1938-39 (2006).